No. 75-731

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SUN OIL COMPANY, ET AL., PETITIONERS

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE FEDERAL POWER COMMISSION

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MEMORANDUM FOR THE FEDERAL POWER COMMISSION

1. This case arises from petitioners' application to the Federal Power Commission under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), for certificates of public convenience and necessity authorizing their sale to Texas Eastern Transmission Corporation of leasehold interests in natural gas reserves in Rayne Field, located in southern Louisiana. Unlike a conventional sale of natural gas, in which a pipeline agrees to pay the producer a specified price per unit of gas delivered, the proposed lease-sale provided for a total price of $134 million to be paid during a 16-year period ending in 1975, although production from the field was expected to continue until 1986 (Pet. App. A9, n. 14).

Because the total volume of gas to be produced from the field was uncertain, the Commission could not determine

whether the proposed sale price, when viewed in terms of the ultimate cost per Mcf to Texas Eastern, would be consistent with the public interest. It therefore determined to "conventionalize" the sale by issuing certificates of public convenience and necessity subject to the condition that future payments by Texas Eastern for gas produced in Rayne Field would not exceed the then-applicable "in-line" rate of 20 cents per Mcf or other applicable area ceiling rate subsequently established by the Commission (Pet. App. G17).[1] Payments were to continue on that basis for the life of the Rayne Field reserves.[2] Although the Commission had initally included a condition requiring petitioners to make appropriate refunds for rates already collected in excess of the applicable maximum (Pet. App. F44-F45), it ultimately determined to defer consideration of "the appropriateness of refunds or their computation" (Pet. App. G14) pending completion of the area rate proceeding that had recently been reopened (see note 1, *supra*).

2. On petitions for review, the court of appeals affirmed the Commission's orders insofar as they "conventionalize[d] some features of the lease-sale arrangement in the public interest" and "displace[d] the lump-sum lease-sale contract price with an initial unit price for the gas" (Pet. App. A133). The court set aside the orders, however, insofar as they (1) adopted the in-line price of 20 cents per Mcf for gas delivered prior to August 1, 1971,[3] (2) provided that payments should continue for the life of the reserves, and (3) deferred consideration of refunds (*id.* at A134).

The court ruled that the Commission was required to use the 18.5 cents per Mcf just and reasonable rate, rather than the 20 cents per Mcf in-line price, "both as the unit price for the gas deliveries to be made [prior to August 1971] and as the basis for refunds by the producers on account of deliveries already made" (*id.* at A73-A74). Although it recognized that the 18.5 cents rate had been stayed by the Commission, that the area rate proceeding had been reopened, and that the rate was subsequently displaced by a higher rate, the court rejected the Commission's contention that the 18.5 cents rate was "so tentative in character as to support the Commission's refusal * * * to employ [it] * * * as the initial price to be paid to the producers for gas delivered after the effective date of that rate" (*id.* at A84).

The court also held that to permit the producers to collect payments for the life of the reserves would result in total payments greater than the original $134 million contract price and would exceed the Commission's "limited power to raise prices for natural gas above those contractually fixed by the parties" (*id.* at A54).

Finally, the court held that it was improper for the Commission to defer consideration of whether to impose refund obligations. It reasoned that the Commission is ordinarily required to order refunds of rates collected in excess

[1]The Commission had earlier established a maximum "just and reasonable" area rate of 18.5 cents per Mcf, but the order establishing that rate had been stayed by the Commission pending further administrative consideration (see Pet. App. G11-G12). The Commission therefore determined that the "in-line" rate of 20 cents per Mcf should govern in the interim.

[2]The Commission initially determined that payments should cease when the producers had received $134 million, the original total sale price of the leasehold interests (Pet. App. F43). The Commission subsequently recognized that the original contract price "will not be of the same value" under the conventionalized sale, because the producers "will receive it over a much longer period" (Pet. App. G10-G11). The Commission accordingly determined that the proposed sale should be more fully conventionalized and that the pricing conditions should "be extended until the exhaustion of the Field" (*id.* at G11).

[3]That was the effective date of the Commission's final determination, after reopening, of the maximum just and reasonable rate for the Southern Louisiana producing area (46 F.P.C. 86, 142).

of the just and reasonable rate (*id.* at A90) and to do so promptly (*id.* at A95-A99).

The court directed the Commission on remand "to increase, beyond the lease-sale contract price, the aggregate amount which Texas Eastern is to pay the producers by a sum equal to the time value of the monies otherwise to be paid," and "to compute, utilizing the then existing 18.5-cent just and reasonable area rate as the basis, refunds by the producers to Texas Eastern on account of gas deliveries prior to August 1, 1971" (*id.* at A134).

3. Petitioners raise two questions: whether the Commission had authority to conventionalize the lease-sale by extending the payments for gas deliveries over the life of the Rayne Field reserves, and whether the Commission must order refunds of rates collected in excess of an 18.5 cents rate that was never in effect and that has been superseded. We essentially agree with petitioners with respect to the merits on both questions.

(a) The Commission is empowered by Section 7(e) of the Natural Gas Act, 15 U.S.C. 717f(e), "to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require." It properly exercised that broad authority in this case by modifying the proposed lease-sale to make it conform more closely to a conventional sale of natural gas.

The Commission's concern with respect to the pricing feature of the lease-sale was its "inflexibility" (Pet. App. G7). "If the price turns out to be too high in the light of changing circumstances, it fails to protect the consumers; if it is too low the producers will not receive an adequate return and this, in turn, may affect their ability to serve the market" (*id.* at G7-G8). Limiting payments to a specified price per Mcf with an upper limit equivalent to the value of the original lump-sum price—the result required by the court of appeals—would protect against an unduly high price but not against an unduly low return. The latter purpose was to be served by extending the payments over the life of the Rayne Field reserves. It was within the Commission's authority under Section 7(e) to attach that condition in the public interest.

This Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, and *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348, do not restrict the Commission's authority to attach appropriate conditions to its issuance of certificates of public convenience and necessity. Those decisions hold that a jurisdictional company may not, merely by filing a new rate schedule, unilaterally change the rate specified in its contract for sales *previously certificated* by the Commission, and that the Commission may order such a change, in disregard of the contract, only upon a finding that the existing rate "is so low as to adversely affect the public interest—as where it might impair the financial ability of the [company] to continue its service" (*Sierra Pacific, supra,* 350 U.S. at 355).

Attaching to the issuance of a certificate a price condition that has the effect of increasing the total contract price does not implicate the *Mobile-Sierra* doctrine.[4] In any event, the Commission's finding here—that the lump-sum provision could "affect [petitioners'] ability to serve the market" (Pet. App. G8)—satisfied the relevant standard.

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[4]As this Court stated in *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 391-392, attaching a price condition at the certification stage "is not an encroachment upon the initial ratemaking privileges allowed natural gas companies under the Act, * * * but merely the exercise of that duty imposed on the Commission to protect the public interest in determining whether the issuance of the certificate is required by the public convenience and necessity * * * ."

(b) The Commission determined to defer consideration of refunds until the reopened Southern Louisiana area rate proceeding reached a conclusion. The Commission stated (Pet. App. G14):

> [I]t is our opinion that the public interest precludes our ordering refunds to be paid by the Rayne Field producers at this time. * * * [T]he one objective that must always be kept in sight is the need to provide fair and equal treatment for all of those regulated. It is essential, therefore, that the four producers involved in this proceeding should be afforded the same treatment as will be given to all other producers in Southern Louisiana. In this regard, we believe that the just and reasonable rates which ultimately flow out of any settlement, or further proceedings [in the Southern Louisiana area rate proceeding], should govern the level of payments in this case prior to October 1, 1968, as well as after that date. While we may find ultimately that refunds should be paid, we need not discuss here the contentions * * * with respect to the appropriateness of refunds or their computation (assuming a firm Southern Louisiana area rate).

It is settled that the Commission has "discretion * * * under §4(e) of the Act * * * to refrain from imposing a refund obligation" (*Federal Power Commission* v. *Texaco Inc.*, 417 U.S. 380, 392). It was not an abuse of that discretion to defer consideration of refunds in this case pending the completion of related administrative proceedings concerning the refund obligations of similarly situated producers.

Although "it is the duty of the Commission, 'where refunds are found due, to direct their payment at the earliest possible moment consistent with due process' " (*United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223, 230), the Commission here did not find

refunds due. Rather, it reasonably determined to postpone consideration of that question. The Commission "was not *required* to delay this refund" (*ibid.*; emphasis added) pending final determination of a just and reasonable rate for the Southern Louisiana producing area, but neither was it precluded from doing so.

Not only did the court of appeals erroneously order the Commission to impose refund obligations "forthwith" (Pet. App. A101), but it insisted that the refunds be predicated "upon the just and reasonable rate of 18.5 cents previously established in the [first] *Southern Louisiana Area Rate Proceeding*" (*ibid.*). The order establishing that rate, however, was never made effective; although it was affirmed by the Fifth Circuit, that affirmance, as this Court later recognized, "was not 'unqualified' " (*Mobil Oil Corp.* v. *Federal Power Commission,* 417 U.S. 283, 310). The Commission was authorized to, and did, reopen the proceeding, and it ultimately established a new just and reasonable rate which was upheld by this Court in *Mobil.*

Since the order establishing the 18.5 cents rate "was therefore not final" (*id.* at 312), and was in fact withdrawn by the Commission prior to the court of appeals' decision in this case (see *id.* at 298, 311; 46 F.P.C. 86, 102), there was no basis for the court's directing the Commission to predicate refunds on that superseded rate. Indeed, the result—treating these producers differently from others in the Southern Louisiana area—is precisely what the Commission had sought to avoid by deferring consideration of refunds.

4. Although the court of appeals' decision, in the respects at issue here, is incorrect, its effect appears to be limited to the peculiar facts of this case. The underlying purpose of the lease-sale agreement that gave rise to this litigation was to attempt to circumvent the Commission's jurisdiction over producer sales of natural gas.

After this Court held in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, that sales of leasehold interests in proven reserves are within the Commission's jurisdiction, no new lease-sales were proposed, and it seems unlikely that such transactions will reappear in the future. The Commission therefore does not believe that the court's decision will seriously interfere with the performance of its regulatory responsiblities under the Natural Gas Act.

Looking solely to the present litigation, however, the Commission believes that the decision improperly requires the imposition of inequitable and unreasonable refund obligations and erroneously compels the Commission to omit a condition designed to protect petitioners' "ability to serve the market" (Pet. App. G8). While those considerations did not seem to be of sufficient general importance to warrant the Commission's seeking certiorari, they do serve to distinguish this case from one in which a court's error affects only private interests. Because we share petitioners' view of the merits, and because the questions presented implicate public interest considerations related to the outcome of this litigation, we do not oppose the granting of the petition for a writ of certiorari.

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FEBRUARY 1976.